This is the crux of the question of sales taxation as a substitute for the present forms of national taxation. Is it desirable to transfer the tax burdens from the richer classes to the poorer classes? By curtailing the investments now being made by the poorer classes, small as they are, and by augmenting the investments of the rich, the ownership of the wealth of the country will be shifted still more into the hands of a relatively small part of the population.

Is this desirable, even if it means an increase in capital investment? There is already marked inequality in the ownership of wealth. Professor W. I. King estimated that in 1910 two per cent of the people of the United States owned approximately sixty per cent of the wealth of the country.

And further, is it desirable to diminish the consumption power and thereby reduce the standard of living of the poorer classes?

SUMMARY

The incidence of a sales tax would be upon both producers and consumers. In the case of an article produced under competition at increasing expense per unit of output, as tends to be true of agricultural and mineral products, the tendency would be for the price to rise, but to increase by less than the amount of the tax. If the expense per unit is uniform regardless of quantity of output, which is true of but relatively few articles, the sales tax would tend to increase price by the amount of the tax. If the expense per unit of product decreases as output increases, as is generally true in manufacturing or selling, a sales tax would tend to increase the price by more than the amount of the tax. The incidence of a tax upon the sales of a monopolist would be upon the consumer, in part, at least. The excess profits tax and the income tax are not now borne by the consumer. The substitution of a sales tax for the excess profits tax and its substitution for the higher reaches of the income tax would thus cause the poorer classes in their purchases to bear part of the tax burden now being borne by the richer classes. This would tend to decrease the standard of living of the poorer classes and to increase the concentration of wealth.

The General Sales Tax Is Not the Way Out

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CONSUMPTION taxes and other miscellaneous excise taxes must be relied upon to furnish a reasonable proportion of the vast sums needed as post-war revenues of the United States. A billion dollars sufficed for the fiscal year 1917; for current years, expenditures and necessary debt reduction can scarcely be taken care of with four billion.[1] To place the bulk of the revenue burden upon consumption, through the instrumentality of the widely urged general sales tax would,

[1] The Annual Report of the Secretary of the Treasury, submitted to Congress in December, 1920, indicates that the ordinary expenditure for the fiscal year ending June 30, 1921, will be as much as $4,851,298,931 and that the corresponding figure for the fiscal year ending June 30, 1922, will be $3,897,419,227. These figures are not inclusive of any amounts for reduction of the public debt, and are based in the main upon estimates. Through the action of Congress the actual expenditures may be reduced below these estimates. It does not seem possible, however, that expenditures for this year or next year can be reduced much below four billion.

however, be unjust and unsound. Such a course would be a reversion to methods of taxation discredited by modern thought.

Under the revenue legislation now in force, according to the latest reliable estimates, out of a total estimated yield for the calendar year 1921 of approximately four billion, there will be derived from taxes on tobacco, admissions, transportation, automobiles, musical instruments, sporting goods, candy, toilet articles, jewelry and luxuries about $1,300,000,000, compared with a yield of somewhat less than one billion from the individual income tax, about half a billion each from the income tax and from the excess profits tax on corporations, $200,000,000 from minor business taxes such as the capital stock tax, stamp taxes and license taxes, and somewhat under $400,000,000 from customs duties.[2]

Thorough-going proponents of the general sales tax urge that the tax system be changed so that the greater portion of the revenue will be derived from a flat tax on sales or "turnover." The rate ordinarily proposed for such a tax is one per cent, and estimates of the yield relied upon by them vary from somewhat less than two billion to as much as six billion. The taxes which they would supplant are the excess profits tax, the current estimated yield of which is rather less than half a billion, the corporation income tax, and at least the greater part of the individual surtaxes. Sales tax advocates are not clear and not in harmony among themselves as to what would be done with the present miscellaneous consumption taxes, but presumably these would be in the main supplanted by the general flat tax.

In current discussions proposals for far-reaching uniform sales tax take at least three forms:

1. A tax on every sale or turnover not only of commodities but also of services, real property, capital assets and on rent and interest.
2. A tax on every business sale or turnover of goods, wares and merchandise—sometimes referred to as the merchants' gross sales tax.
3. A tax on all final sales of goods, wares and merchandise for consumption or use.

The first two differ only in the scope of their application, and most of the difficulties with the wholly inclusive tax apply also to what is left within the scope of the more modified second form. While the first form "a tax on all sales by anyone to anyone" would have the merit of simplicity in definition, it is scarcely conceivable that any tax seriously considered for adoption would include the bothersome item of services, or would be made so burdensome as to cover sales of real estate, sales of securities or sales of capital assets. A tax in the third form, on "final retail sales" only, would involve so much practical difficulty in requiring the constant distinguishing of final sales for consumption from other sales, and would have to be so high, probably at least four or five per cent, to yield the amount desired by sales tax advocates, that it does not require special consideration. Discussion is therefore directed to the tax in the second form—a tax on all sales of goods, wares or merchandise, at a rate sufficient to yield the bulk of the needed revenue. It is assumed that

[2] These figures are taken from an unofficial estimate made in January, 1921, by Dr. Joseph S. McCoy, Actuary of the Treasury Department—*see* revised report of the Tax Committee of the National Industrial Conference Board. Preliminary statements as to the amount of income and excess profits taxes paid on March 15, 1921, appear to indicate that the actual yield, which was very difficult to gauge because of the changed business conditions, will be somewhat higher than this estimate.

such a tax would be assessed upon the net sales of each taxpayer, presumably for each month, and would not be required to be collected from the buyer by the seller as a separate item. Such a requirement is clearly not adapted to conditions prevailing in commercial transactions in this country, and would constitute an intolerable clog and annoyance.

The general sales tax seems on first consideration to afford the most attractive solution of the revenue problem. The advocates of this tax maintain that it would easily furnish the bulk of the needed revenues; that it would be the fairest of all taxes, because under it, all transactions are treated alike; that it would be economically beneficial through freeing for investment purposes funds now absorbed in taxation, and through furnishing incentive for industrial effort by increasing the portion of profits that could be retained; that it would be easier upon the consumer than present forms of taxation because there would be less "pyramiding" of taxes; that the taxpayer would always know where he stood in reference to his obligations to the government instead of being involved, as at present, in long continued doubt and uncertainty; that the government would be more securely financed through a tax which did not depend upon profits, and more conveniently financed by reason of the collection of the bulk of the revenues each month instead of at quarterly periods; and that the tax would be far easier for the government to administer than income and profits taxes.

This is a formidable array of arguments, but analysis shows that the only arguments for the general sales tax having any substantial foundation are those of convenience, and that even here the advantages are generally exaggerated. In its fundamental aspects the general sales tax is open to objections broadly classified as follows:

1. The general sales tax is essentially unjust in that it is a tax levied according to needs rather than according to ability to pay.

2. The general sales tax is grossly discriminatory. Insofar as the tax can not be shifted it is distributed according to gross income, which furnishes no measure of taxpaying ability. This tax treats as being alike transactions which are fundamentally unlike; it subjects to very unequal risks taxpayers in substantially similar positions; it affords an indefensible bounty to the large integrated industry as compared with smaller industrial units.

3. The tax rests upon an artificial basis in that it turns upon the mere form of business transactions, and would lead to undesirable changes in business practices.

Approach to the general sales tax is frequently made through the avenue of foreign experience. There is, however, very little in experience in other countries to commend the tax theoretically, or indeed to furnish any basis for a judgment as to how it would operate under the very different conditions prevailing in the United States. The sales tax is by no means new; it was used in Egypt, in Babylonia and in Rome.[3] Under the rule which prevailed in France prior to the Revolution, and which has prevailed in many instances when a privileged aristocracy was in a position to dictate the method of securing the funds of the state, the greater part of the revenue was drawn from sales taxes which applied directly to the necessities of the common man. One of the chief objects of the democratic movement was to get rid of methods so oppressive.

[3] For remarks and as to the history of the sales tax and foreign experience, see Professor E. R. A. Seligman's report, Proceedings of the Second National Industrial Tax Conference (1920), pages 70–83.

THE SALES TAX IN OTHER COUNTRIES

In current practice the most notable instances of the use of the general sales tax are those of France and Canada. In neither case is the tax a flat general tax. In France the turnover tax instituted on July 1, 1920, covers three categories:

1. 1.10 per cent on general turnover, except such turnover as comes under headings 2 and 3 below.
2. 3 per cent on all business classified as category 11 of luxury trades (articles which are considered as luxuries if price exceeds a certain figure).
3. 10 per cent on all business classified as category 1 of luxury trades (articles, which from their nature, are considered as luxuries).

It is clear that it was regarded as unreasonable to adhere to a general flat rate, and that the classification of articles adopted must involve many difficult distinctions. According to official reports it furthermore appears that this tax is yielding not over forty-five per cent of the estimated revenue. France has been notably backward in the development of a modern, adequate system of taxation.

The Canadian tax rests upon sales of finished articles by manufacturers, wholesalers and jobbers. As originally adopted it was coupled with other taxes upon the sales of a variety of specified commodities at rates of 3 per cent, 5 per cent, 10 per cent, 15 per cent, 20 per cent and 50 per cent, and was subject to a long list of exemptions which included all food products, building materials for construction purposes, fuel, and other articles, and was subject to the power of the governor and council to add to the list of exempt articles so far as it was deemed expedient or necessary. The luxury taxes have been recently modified to meet the changed business conditions. Neither in France nor in Canada is the volume or complexity of transactions at all comparable to those in the United States.

In the Philippines the one per cent sales tax often referred to, which represents a continuation of Spanish methods, applies to sales of merchandise in raw, manufactured or partly manufactured state and also to the sales of various kinds of services including those by power, transmission and transportation companies, but is subject to a large number of exemptions including the sales of agricultural products used by farmers and the sales of small merchants. Philippine business is too trifling for mention in comparison with United States business, and we can not turn to the Philippines for instruction in the field of finance any more than in the field of politics. Mexico has indeed a comprehensive general sales tax, but even the Carranza government, after a careful report, recommended abolition of the tax because of cost of collection and the injustice to the poorer classes. One of the first acts of the United States on coming into the possession of Cuba was to abolish the old sales or *consumo* tax and substitute other methods of taxation. In England, where taxation is generally believed to have been handled with greater consideration and intelligence than in any other country, the sales tax has been carefully considered and rejected; so also in Italy.

DOES NOT DISTRIBUTE REVENUE BURDENS FAIRLY

To warrant adoption for a major source of revenue, other than as a last resort, a tax must be shown to rest upon some principle which makes it fair to the average citizen. The general sales tax rests upon no such principle; its theoretical basis is the bald proposition that the consumer must

foot all the bills. This proposition makes about the same appeal to the citizen as did Ricardo's "iron law of wages" to the workingmen. That "law" doomed the wage worker to the minimum wage needed for bare subsistence; the sales tax, resting upon no higher ethical basis, would levy a toll even upon that wage.

That the consumer would pay the general sales tax is the outspoken and fundamental position of its advocates. And the burden which they would lay upon the consumer is not light, as implied by the one per cent rate usually suggested, but heavy. The minimum yield desired is two billion dollars—more than the entire yield of the income tax at its highest. The rate necessary to procure the revenue desired from this source would very likely be as much as two per cent instead of one per cent. The most reliable estimate of the yield of a one per cent tax covering sales of all kinds by traders, manufacturers, mines and farms—the estimate of Dr. Joseph S. McCoy—is $1,100,000,000. To assure two billion or more it would therefore seem to be necessary to make the rate two per cent.[4]

Under this tax all sales transactions would indeed be treated alike, but far from being just this uniform treatment would be grossly inequitable. It has been wisely remarked that no injustice exceeds that of treating as equals things which are unequal. The general sales tax would levy toll upon sales of bread, of medicines, of ploughs, of tools, of building materials, of the simplest clothing, and would levy toll at the same rate from the sale of jewels, candy and of automobiles. Sales do not pay taxes, the money must come from the buyer or the seller. There is nothing whatever in the fact that all desired goods must be bought, which warrants a conclusion that all buyers can justly pay to the government the same percentage on the price of what they buy. The one argument for such a method of tax is that sales may furnish a basis for collecting revenue which is convenient. That argument may suffice for a levy very small in total burden, or resting upon articles not of prime necessity, but it fails to justify a uniform toll upon all articles, both necessities and luxuries.

In sharp contrast, the income tax rests not upon needs but upon ability to pay. That ability is measured generally by the taxpayer's increase in assets over the taxable period, and increases progressively with the amount of the income. Here we have a genuine principle commending itself as fair to the individual. More effort upon the part of the taxpayer and of the government is required for the collection of taxes according to this principle, but as in almost every field painstaking effort is the price of justice.

Sales tax advocates urge, however, that the consumer pays the taxes now —not only the excess profits tax, but also the income tax. The position that the consumer pays income and profits taxes is somewhat difficult to reconcile with the zeal of sales tax advocates to do away with such taxes on the ground that they stifle industry. How can industry be burdened by taxes which are passed on? The truth of the matter is probably that taxes assessed against net incomes from business activities are in part shifted.[5] Under conditions such as prevailed during the war, those of a "sellers'

[4] See report of the Tax Committee of The National Industrial Conference Board, December, 1920, pages 13–14.

[5] For an interesting and illuminating discussion of the relation of the income and excess profits tax to prices. see David Friday's *Profits, Wages and Prices*, Harcourt, Brace & Howe, 1920.

market" taxes on business income may be largely shifted, while under conditions such as now prevail they may be shifted to a relatively small extent. Always the producer near the margin finds it difficult to shift, for his prices can not be increased. Decisive here, however, is the consideration that the placing of the bulk of the tax burden directly upon income and profits leaves it in the first instance where the ability to pay is clear, and in such a way that the largest possible portion will actually be paid through subtraction from income and profits.

That there would be less "pyramiding" of the general sales tax in the course of passing it on than of the income and profits taxes is a proposition without real foundation. Colorable support for this idea is drawn from a picture of the sales tax as a one per cent item which can be added as an item of a particular invoice. Waiving the difficulty that very many sales are not invoiced at all, it is apparent that even for invoiced sales one per cent covers the tax only in the case of initial sales of raw materials, and even then only approximately. When the manufacturer or dealer comes to make a sale, he must, in order to cover the tax which he has had to pay or bear, allow not only for the tax applying to what he sells but for many things purchased by him subject to tax, not resold by him but constituting elements of expense such as equipment, packages, fuel and the like. Under any practicable sales tax plan this tax, like any other item, will so far as possible be treated by the sellers simply as an element of expense, not separately disclosed to the buyer, and subject to the same possibility of increase when passed on as is any other item of expense. Under this tax, as under income and profits taxes, the seller will charge all that he believes he can charge wisely, and the buyer must depend for protection against pyramiding not upon the form of tax but upon the maintenance of competitive conditions.

Keeping up a flow of profits available for investment in industry is essential to the successful working of the industrial system. It is, however, difficult to urge that business profits should in such times be left free from any substantial tax and that the needs of the government should be met by the consumer, whose participation in the benefits of the investment process is rather more limited than the participation by the investors themselves. So long as government expenditure remains inordinately high, the flow of capital for investment is bound to be checked, whatever the form of taxation. Just distribution of the revenue burden is a consideration of even more pressing importance to those who desire to maintain the present industrial system than the full maintenance of the flow of profits for investment. On no economic or social principle so far developed can the general sales tax stand comparison with income taxes as the major revenue source.

INDEFENSIBLE DISCRIMINATIONS

Subjected to the same tax, sales transactions of every sort would result in indefensible discrimination in the distribution of the tax burden.

So far as the general sales tax is not shifted to the buyer it would constitute a tax distributed according to gross income. Such income furnishes no test of taxpaying ability. A manufacturer having a substantial investment in plant and comparatively small turnover may realize on his sales a high percentage of profit, his net profit being a large percentage of his gross receipts. If we assume that on sales of $500,000 such a manufacturer realizes fifteen per cent or $75,000, the sales tax

which he would be required to pay, if he could not shift the tax, would, at the rate of one per cent, amount to $5,000. In many lines, notably in jobbing and some retail lines, the gross profit is very low and the large turnover is what produces a satisfactory return upon the capital. Thus, according to the reports of the Harvard bureau of business research the average wholesale grocer turns his capital five times a year and makes a net profit on his sale of somewhat less than two per cent. To result in $75,000 profits the sales of such a grocer would have to amount to $3,750,000. The grocer's tax upon such sales would, at one per cent, amount to $37,500. Accordingly, if the grocer could not shift his tax he would in the case assumed be paying more than five times as much to the government as the manufacturer, although his net profits, except for the tax, would be exactly the same. The government would take one-fifteenth of the manufacturer's profit, but would take one-half of the grocer's profit. This is by no means an extreme case, for the difference in rates of net profits and the range of difference in relation of net to gross are very great. Nor is it idle to say that a large part of the total burden of the sales tax could not be shifted. Merchants selling goods at established prices or selling broken lots, merchants already charging all that the traffic will bear without destructive loss of volume, would be helpless before the discriminatory levy of the general sales tax.

Even where the tax can be largely shifted those who pay it in the first instance are subject to very unequal risks. In the illustration stated the manufacturer in making his payment to the government risks only $5,000 while the grocer risks $37,500. The government would take the money but would give to the taxpayer neither guarantee of his ability to collect it out of the buyer nor justification for requiring him to pay it himself. This levy would operate not only in prosperous times when the taxpayer would feel able to pay it or in a position to collect it out of the buyer but also in hard times when unavoidable expense can barely be met.

Discrimination through the cumulative effect of the general sales tax has been often pointed out but never explained away. How this results is seen by considering such a situation as, for example, that existing in the shoe industry. Here, if the business is conducted by a great integrated enterprise, there may be but one or at most two sales between the raw leather and the delivery of shoes to the wearer. While if the different steps in the process are carried on by small dealers there may be five or six sales as follows:

1. Hides to tanner.
2. Tanner to leather merchant.
3. Leather merchant to shoe manufacturer.
4. Shoe manufacturer to jobber.
5. Jobber to retailer.
6. Retailer to consumer.

Where the goods pass by successive sales through six hands a sales tax will be levied six times. Where the goods move directly from the tanner to the consumer there would be one tax. The profits in the shoe industry are in general a very small proportion of gross receipts, frequently as low as two per cent, and this discriminatory cumulative tax burden might mean the difference between the success and failure of the small units. Even more striking instances of the disastrous cumulative effect of the tax might be taken from other lines of industry such as the textile field or the field of the metal industries, where there may be seven or eight sales between the raw

material and the placing of the finished articles in the hands of the consumer.

Under the income tax such discrimination does not occur. The net profits resulting from each stage in the process of manufacturing are taxed to the small unit where they are realized by small units but are also taxed to the great enterprise where that enterprise realizes profits from several different processes. That small units have been able to survive in many fields of industry in spite of certain advantages enjoyed by larger enterprises furnishes no justification for placing upon them a discriminatory tax burden, and on the contrary makes it clear how desirable it is to keep the small enterprise free from such burdens. It does not appear to be practicable to meet this difficulty of the cumulative effect of the general sales tax by attempting to apply the tax to each clearly marked stage in the processes of the integrated industry. The large manufacturer does not and can not sell raw materials to his factory or finished goods to his jobbing branch, and to attempt to set an imaginary price on the goods as they pass from one stage to another would lead to endless difference of opinion and confusion. Taxes to be practicable must follow transactions and not create them. They must be made to rest upon real transactions, not upon imaginary transactions.

UNDESIRABLE BUSINESS PRACTICES

Even as applying to actual sales the turnover tax would rest upon an artificial basis and would result in undesirable changes in business practices.

The use of direct sales upon which this tax would rest would probably be materially restricted in order to avoid the tax. Even where the tax could be shifted it would still be a substantial competitive advantage so to conduct business as to avoid accumulation of the tax. The burden of a one or two per cent tax on gross sales added at various stages is by no means light and would be emphatically worth saving. Hence the woolen manufacturer instead of buying his yarn would buy the wool and hire the spinner to make it up into yarn, and would also hire the dyer and the finisher. Sending of goods out to be processed would become a standard practice; consignments would take the place of direct sales. Effort to avoid the tax might result in the absorption of small units into the larger enterprises, a process that might have some advantages but which is not to be justly accelerated by a scheme of taxation.

Some advantages of convenience to the taxpayer the general sales tax undoubtedly has. It is simpler to make up a statement of net sales than a statement of net profits; it is easier to pay monthly than to pay quarterly; it is a relief to feel that a tax paid can not be the subject of any real difference of opinion. Yet these advantages of convenience are less important than it seems. Even though the general sales tax were adopted as a major source of revenue, a modified income tax would very likely be retained so that the sales tax reports would be additional and not in substitution for net income reports. Quarterly payment of income taxes as now permitted enables a prudent taxpayer to adjust his financing in a reasonably convenient way. Differences as to tax assessments, which have been so frequent, have arisen mainly as to excess profits taxes. That tax is distinctly a war tax. It ought to be abolished at the earliest possible date, and it can be abolished without resort to the general sales tax. Under the income tax alone, with increasing experience by taxpayers in the application of the

tax, increasing improvement in the structure, interpretation and administration of the tax, difficulties with it should be far less in the future than they have been in the past when it has been a new tax operating under war conditions. What advantage in the convenience of the sales tax compares with the advantage of the income tax in ceasing to accrue when there is no net income?

This very consideration, that the income tax diminishes in yield in bad years, of course emphasizes the need of the government to have at all times sources of revenue other than income taxes. Such sources can, however, be maintained as they have been without resort to the wholly inclusive general sales tax. So far as sales taxes are needed, and they will be needed for some time, use can continue to be made of taxes levied upon the sales of selected articles not of prime necessity and levied at one stage of the process only so as to avoid any cumulative effect.[6]

That objections to the general sales tax are much more than academic is shown by the rejection of the tax by the United States Chamber of Commerce in the recent referendum to its constituent local chambers of commerce throughout the United States; by the Tax Committee of the National Association of Credit Men; and notably by the rejection of it, after careful consideration and investigation, by the Tax Committee of the National Industrial Conference Board.

[6] For a discussion of the methods of replacing revenue lost through the abolition of the excess profits tax and reduction of surtaxes, *see* the report of the Tax Committee of the National Industrial Conference Board, Special Report No. 18, December, 1920. See also in such report the discussion of the general sales tax and full statement of the reasons which induced a report against this tax by a committee unusually representative of industry.

The Tariff Policy of the United States As a Creditor Nation

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THE problem of providing the United States Government with sufficient revenue to meet its fiscal requirements is one which, of necessity, is demanding the thoughtful attention of those charged at the present time with that responsibility. With the loss of excise taxes due to prohibition and the increasing diminution in the returns from the chief sources of revenue under existing laws —the income and excess profits taxes— it is not surprising that this country should turn to the tariff as a possible means of raising additional revenue. Indeed, it is a repetition of history that import duties should be called upon to help meet the revenue burdens occasioned by war and, furthermore, that an upward revision of the tariff schedules should be strongly agitated in a period of unbalanced domestic markets by those who fear the importation on an extensive scale of commodities produced abroad under supposedly more advantageous conditions.

Current estimates indicate that something in excess of four billion dollars will constitute the minimum ordinary fiscal needs of the government for the next two years, exclusive of the retirement of the certificates of